

In general, Voice Over Internet Protocol ("VOIP") is telecommunications subject to tax within the meaning of "Telecommunications" and "Gross Charges" pursuant to The Telecommunications Excise Tax, 35 ILCS 630/2; the Telecommunications Infrastructure Maintenance Fee, 35 ILCS 635/10; and the Simplified Municipal Telecommunications Tax Act, 35 ILCS 636/5-7. (This is a GIL.)

January 12, 2005

Dear Xxxxx:

This letter is in response to your letter dated September 23, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

ABC, a supplier of tax compliance software to the telecom industry, is researching the taxability of 'Voice over Internet Protocol' service, sometimes abbreviated as 'Voice over IP' or 'VOIP.' This service enables subscribers to send and receive telephone messages in a new manner: one's voice is converted into 'packetized data' and then transmitted over a data network such as the public Internet or a privately managed IP network. End-to-end, a VOIP call can take one of four possible forms: (1) phone-to-phone; (2) phone-to-computer; (3) computer-to-phone; or (4) computer-to-computer. It is our understanding that, in the first three cases, the call also travels over the public switched telephone network (PSTN), whereas, in the last instance, the transmission completely *bypasses* the PSTN. Finally, as to billing practices, a VOIP provider typically bills its subscribers a fixed monthly rate for unlimited local plus long distance service and/or a cents-per-minute usage-based charge for each VOIP call. With this introduction in mind, we pose these questions:

- 1) Are either 'fixed-rate' or 'usage-based' monthly charges for VOIP telephone service subject to the tax liability noted above in your state?

- 2) If 'yes,' would taxability be negated if a particular VOIP call were routed so as to bypass the public switched telephone network (PSTN)?
- 3) Is the basis for taxability the determination that the service meets the definition of a taxable 'telecommunications service'? (If not, please explain the alternative basis of taxability.)
- 4) If VOIP service is taxable, how is such service sourced to your state? For example, would your state claim jurisdiction over VOIP service based solely upon the geographic residence or business address of the VOIP subscriber?
- 5) Moreover, since the exact physical location of the origin and terminal points of most VOIP calls cannot be identified with certainty, would your state instead apply the '2-out-of-3 rule' for sourcing individual calls? If so, in the absence of precise location information, what basis would your state rely upon to establish the points of origination and termination of each call? For example, could a subscriber's primary usage address be used? Or could a different method, such as identifying the caller's **area code + 3 digit local exchange**, serve as an acceptable sourcing procedure?
- 6) Finally, if VOIP service is considered taxable, does taxability extend to:
 - (A) Service activation/de-activation fees?
 - (B) Charges for 'vertical features' (e.g., call forwarding, call waiting)?
 - (C) Fees for 'virtual phone numbers' (second phone numbers issued to a subscriber as an alternative to one's main number)?

My initial research into and reading of Illinois law for this project finds that tax liability attaches to revenues of 'telecommunications retailers,' so the question becomes, are VOIP providers telecom retailers for Illinois tax purposes? There is, however, a question as to whether VOIP will even be considered telecom or, rather, a 'computer data processing service.' I look forward to hearing your thinking on & determination of this issue.

Please respond in writing, by letter, e-mail or fax, at your earliest convenience, and thank you in advance for your assistance.

DEPARTMENT'S RESPONSE:

The Telecommunications Excise Tax Act imposes a tax on the act or privilege of originating or receiving intrastate or interstate telecommunications by persons in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers by such persons, 35 ILCS 630/3 and 4. The tax imposed shall be collected from the taxpayer by a retailer maintaining a place of business in this State and remitted to the Department, 35 ILCS 630/5.

The Act defines gross charges as including amounts paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by retailers, 35 ILCS 630/2(a). Please refer to 86 Ill. Adm. Code 495.100. As a general proposition, if the charge for any item is not separately identified and disaggregated in the retailer's records from charges that are subject to Telecommunications Excise Tax, the entire amount

will be subject to tax. For example, charges for voice-mail or answering services are subject to the Telecommunications Excise Tax unless they are disaggregated from transmission charges and separately identified in the books and records of the telecommunications retailer, 86 Ill. Adm. Code 495.100(c).

Further, the definition of telecommunications under the Act is very broad and encompasses Voice Over Internet Protocol communications. More specifically, the Act states that "Telecommunications", in addition to the meaning ordinarily and popularly ascribed to it, includes, without limitation, messages or information transmitted through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunications service; specialized mobile radio; stationary two way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiber-optics, laser, microwave, radio, satellite or similar facilities. See 35 ILCS 630(2)(c).

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Both the Simplified Municipal Telecommunications Tax Act and the State's Telecommunications Excise Tax Act define service address as: "Service address" means the location of telecommunications equipment from which telecommunications services are originated or at which telecommunications services are received by a taxpayer. In the event this may not be a defined location, as in the case of mobile phones, paging systems, and maritime systems, service address means the customer's place of primary use as defined in the Mobile Telecommunications Sourcing Conformity Act.

For air-to-ground systems and the like, "service address" shall mean the location of a taxpayer's primary use of the telecommunications equipment as defined by telephone number, authorization code, or location in Illinois where bills are sent. See 35 ILCS 630/2(n) and 35 ILCS 636/5-7.

Under the Mobile Telecommunications Sourcing Conformity Act, only those charges for mobile telecommunications that are billed to the customer's "place of primary use" in Illinois by the customer's home service provider may be subject to tax in Illinois. 35 ILCS 638/20.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess
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